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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

NOS. 34, 35, 36

IN THE MATTER OF THE

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, Debtor

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, Debtor

Petitioner,

vs.

MUTUAL SAVINGS BANK GROUP COMMITTEE, ET AL.,

Respondents.

BRIEF OF LIFE INSURANCE GROUP COMMITTEE AND MUTUAL SAVINGS BANK GROUP COMMITTEE, IN OPPOSITION TO THE DEBTOR'S MOTION TO SUPPLEMENT THE RECORD.

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December 29, 1942.

THE TWENTIETH CENTURY PRESS, INC., CHICAGO

IN THE

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This is the brief of Life Insurance Group Committee and the Mutual Savings Bank Group Committee in opposition to the motion of the stockholders[1] to supplement the record in this cause.

FOREWORD AND SUMMARY OF ARGUMENT.

The motion of the stockholders is that in passing upon their petition for certiorari the Court receive and consider data which relates to, but does not in fact show, the income of the property from war-time traffic. It is a matter of common knowledge that war traffic has increased railroad earnings. In its very nature that increase is temporary and not fundamental. Our objection here is to the misleading character of the data offered and to the use which is made of it. The motion is opposed on the following grounds:

1. The present cash position of the Trustee is the result of the fact that during the period of bankruptcy there has been an accumulation of accrued and unpaid interest on debt in excess of $100,000,000, and that the large amount of federal income taxes which have been accrued on the Trustee's books have not been paid.

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[1] While the motion is filed in the name of the bankrupt corporation, it is in fact made solely on behalf of the excluded stock interests.

2. The income of the road in the period since the effective date of the approved plan of reorganization, January 1, 1939, including the income for the year 1942, does not impeach the fairness of the plan in excluding the stock interests; on the contrary the income for that period has been insufficient to service in full the new securities provided by the plan.

3. The Commission's report shows that the element of earning capacity to which it gave dominant weight in fixing the capitalization of the property was not the earning capacity in boom years, or in depression years, but in normal future years, as shown by a most exhaustive study by the Bankruptcy Trustee's chief traffic, operating and accounting officers. In this manner the Commission sought to create a capital structure which would stand for the indefinite future, and the approved plan which rests upon that broad base could not be impeached by the earnings from war traffic in a particular year, even if on a much higher level than those realized in 1942.

4. The same conditions which have now created an almost unprecedented level of railroad traffic have also imposed heavier taxes and have otherwise increased costs and, within the month, have given rise on the one hand to demands by certain governmental agencies for sweeping freight rate reductions and, on the other, to large demands for increased wages by virtually all railway employees. The revenues and expenses of the railroads are constantly subject to the operation of so many forces of this character that their earning position is never static. Experience has

shown that the procedure under Section 77 is such that the reorganization of a large railroad cannot be consummated over the opposition of the stock interests in a short period. While the reorganization of this property is already well into its eighth year, the Circuit Court of Appeals, in approving the plan, had before it the results of the road's operations for the full year 1941.[1] If the record is held to be stale and reopened for the admission of further evidence every time conditions arise which may temporarily affect income, reorganization can never be accomplished, and the purpose of the statute is defeated.

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[1] The Commission's plan was certified to the District Court on April 2, 1940, at which time the Commission had before it the reports of operation for the full year 1939. (R. 3661) The plan was approved by the District Court on October 12, 1940 (R. 5089), and was confirmed by it on June 27, 1941. (R. 5591) The orders of the District Court approving and confirming the plan were affirmed by the Circuit Court of Appeals on February 9, 1942. (R. 5787) Under the applicable rules monthly reports are required to be filed with both the Commission and the District Court and a similar requirement was extended to the Circuit Court of Appeals by its order of September 23, 1941. There was also filed with the Circuit Court of Appeals a statement of "the actual results of 1941" prepared by the general auditor of the Trustee on February 4, 1942. The printed record contains the monthly statements up through April 30, 1941 (R. 5333), and the remaining monthly reports which were before the Circuit Court of Appeals when it decided the case were transmitted as originals to this Court. (R. 5826)

ARGUMENT.

1. The present cash position of the Trustee is due solely to the fact that claims and current liabilities greatly in excess of available cash have not been paid. During the period of the bankruptcy there has been an accumulation of accrued and unpaid interest on debt in an amount exceeding one hundred million dollars, and federal income taxes, which have been accrued on the Trustee's books in a large amount, have not been paid.

In an effort to impeach the Commission's finding that the common and preferred stocks are without value, the debtor asks the Court to receive and consider certain data respecting the 1942 earnings of the property and the present cash position of the estate. It will be shown that much of the data tendered is grossly misleading.

Counsel for the stockholders point out that there is a substantial amount of cash in the hands of the Trustee in Bankruptcy and argue that it should be used, contrary to the provisions of the approved plan, to pay the large indebtedness to the Reconstruction Finance Corporation. It can readily be shown, however, that after payment of current liabilities and claims which the Commission and the courts below have found to hold priority over the debt to the Reconstruction Finance Corporation, no cash remains for reduction of the principal of that claim.

The brief of the stock interests, after stating (p. 8) the amount due the Reconstruction Finance Corporation to be $48,178,750.87, continues as follows:

> "It is clear from the foregoing that the Trustee of Debtor's estate has ample funds on hand as of October 31, 1942, to pay off the indebtedness to the Reconstruction Finance Corporation and still have ample working

> capital to maintain the property of the Debtor now in control of the Trustee. Moreover, Appendix B shows that on November 30, 1942, cash, temporary investments and special deposits aggregated $59,575,918 and Debtor's Comptroller estimates that these items as of December 31, 1942, will exceed $60,000,000 * * *." (Appendix B, pp. 9, 10.)

We challenge the representation which is made to the Court by this argument. It will not bear analysis.

In Appendix B (p. 19) of their brief the stock interests show the estimate of cash in the hands of the Trustee on December 31, 1942, to be $52,508,000. To this amount there is added "special deposits" in the amount of 7½ million dollars, to show a "total" of $60,008,000. The accompanying certificate of the Trustee's Comptroller states:

> "* * * said figures which are described as 'Cash, Temporary Cash Investments and Special Deposits' are gross figures which do not allow for or take into consideration current liabilities, taxes, or other claims upon or against said cash, temporary cash investments and special deposits." (p. 20)

While this caveat is in very broad terms and is proper standing alone, it does not adequately suggest how grossly misleading it is to use these figures in the manner in which they are used in the brief—namely, as showing funds available for the discharge of the indebtedness to the Reconstruction Finance Corporation.

We shall refer first to the second of the two items which is $7,500,000. This is designated as "special deposits" and in the stockholders' brief carries the following note:

> "Includes, as of October 31, 1942, $5,939,930 balance in possession and control of Equipment Trustees from proceeds of sale of equipment trust notes, and

$1,902,189 representing funds set aside for specific obligations." (Their Appendix B, p. 19.)

Used in the connection in which the stockholders would use it, the item itself, and the explanation of it, are deceptive. The full and informative explanation of the item "special deposits", which was written at our request by the Trustee's Comptroller, is set forth in the footnote[1] and shows how erroneous it is to use such an item in support of an argument that the funds covered by the item are available for payment of the Reconstruction Finance Corporation debt. They are not, either in whole or in part.

Disregarding, therefore, this purely fictitious item of $7,500,000, the cash and temporary cash investments, as of December 31, 1942 (estimated), is $52,508,000, and, at the

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[1] "Special deposits" represent funds which are actually segregated from the general funds of the company, invested, held by trustees, or in special bank accounts for specific purposes.

Included in "Special deposits" as of October 31, 1942, is $5,939,930 in the hands of banks and trust companies, who are trustees under equipment trust indentures. This amount represents that part of the proceeds of the sale of equipment trust notes outstanding, or cash advances by the Railway Trustee ("advance rental") not yet paid to equipment manufacturers. Government "freezing" orders have delayed delivery of considerable equipment to be placed under these equipment trusts, and the equipment trustees will hold the $5,939,930 for payment of equipment manufacturer's invoices, or to pay off principal maturities of such equipment trust notes. *Under no circumstances, however, will the above mentioned amount be subject to disposition by the company.*

The remaining $1,902,189 in "Special deposits" as of October 31, 1942, includes the following: $476,852 withheld from wages of employes and payable to the U. S. Government for retirement taxes; $263,944 also withheld from wages of employes, at their direction, for purchase and delivery to them of war savings bonds; $688,393 set aside to provide for taxes assessed, but as yet unpaid pending the outcome of litigation; $469,000 due Eastern lines in adjustment of freight divisions and being paid in accordance with a regular program of monthly settlements; $4,000 held for redemption of bonds which had matured prior to June 28, 1935. *All of these special funds, aggregating $1,902,189, are held for payment of the specific liability or debt named and can properly be drawn upon for no other purpose.*

outset this is to be contrasted with an accumulation of interest on debt *accrued and unpaid* as of the same date, in the amount of $102,617,600.[1] There has also been an accrual of federal income taxes on the books of the Trustee in the amount of $10,792,000, which has not been paid.[1] In short, it is because the lawful debts of the estate have not been paid during the period of bankruptcy that there has been this accumulation of cash.

We desire to show in full detail the uses and purposes to which the accumulated cash in the amount of $52,508,000 must be devoted if the approved plan of reorganization is to be made effective and the debts of estate are to be recognized in the order of their priority. The Comptroller's certificate (stockholders' brief, p. 19) designates the cash figure of $52,508,000 as a "gross figure," which does not "allow for or take into consideration current liabilities, taxes accrued, or other claims upon or against said cash," but it does not identify such current liabilities, taxes, and claims.

At our request the Trustee has furnished us the statement below, certified(1) by his Comptroller which shows that when the cash on hand is distributed or earmarked in accordance with the provisions of the approved plan, the balance of free cash available for all proper corporate purposes on December 31, 1942, is actually $3,280,870, which is less by $3,899,906 than on the effective date of the plan, January 1, 1939. The Comptroller's statement is as follows:

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(1) See Appendix A of this brief.

ESTIMATED CASH ON HAND DECEMBER 31, 1942 AND PURPOSES FOR WHICH HELD, IN ACCORDANCE WITH PROVISIONS OF I. C. C. REORGANIZATION PLAN.

Cash and government bonds 9/30/42			$43,167,000
Estimated net income available for fixed charges (before Fed. taxes) 10/1-12/31	$ 8,600,000		
Depreciation and amortization 10/1-12/31	3,025,000		
Proceeds of salvage, etc	430,000	$12,055,000	
Less payments 10/1-12/31/42:			
Equipment trust interest	$ 124,000		
Interest on unfunded debt	12,000		
Additions and betterments	1,000,000		
Installment payments on equipment and cash for trust equipment	1,098,000		
Balance interest—Court Orders 531 & 577	480,000	2,714,000	9,341,000
Estimated cash and gov't bonds 12/31/42			$52,508,000

PURPOSES FOR WHICH HELD:

Balance in Add. & Better. Fund 12/31/42	$10,338,075	
1942 interest requirements (excl. equip't. trusts) under I. C. C. Reorg. Plan	8,125,303	
Jan. 1, 1943 installment to banks	219,733	
Sinking fund for divisional bonds—4 Yrs.	130,000	
Sinking fund for income bonds—2 Yrs.	1,050,590	
Accrual for federal taxes	10,792,000	
Balance 1940 income for income bonds	231,618	
Balance income for stock 1941	4,792,811	
Balance income for stock 1942	13,547,000	$49,227,130
Balance free cash—unassigned		3,280,870
Total cash and bonds 12/31/42		$52,508,000

RECONCILIATION OF CASH:

Cash on hand Jan. 1, 1939	$ 7,180,776	
Less diversion to increase in other assets:		
Increase in balances due from agents	$ 1,833,492	
Increase in amounts due from U. S. Gov't.	2,109,363	
Increase in material & supply inventory	627,476	
Increase in liabilities over other assets Cr.	670,425	3,899,906
Balance free cash, as above	$ 3,280,870	

Total interest on debt, accrued and unpaid, to December 31, 1942 ... $102,617,600

The items under the caption "PURPOSES FOR WHICH HELD" show that an observance of the approved plan requires the distribution or earmarking of $49,227,130 of the cash in the hands of the Trustee.

The first item of $10,338,075 is the amount which, pursuant to the approved plan, is to be set aside for the additions and betterments which are necessary to enable the road to operate and discharge its public function. In substance it is a depreciation and emergency fund. Other large items cover interest and other requirements which the Commission and the courts below have found to be prior to any reduction of the indebtedness to the Reconstruction Finance Corporation. Another large item is $10,792,000 which represents an accrual on the Trustee's books of federal income taxes. The last two items cover the amounts available for distribution to the new preferred and common stock which has been taken by senior creditors in payment of substantial portions of their respective claims on the basis of $100 per share.

As shown by the Comptroller's statement these allocations leave a "Balance of free cash—unassigned" in the amount of only $3,280,870 as of December 31, 1942. This is actually less by $3,899,906 than the $7,180,776 of "Cash on hand January 1, 1939", the effective date of the approved plan. It is obvious that the payment of the Reconstruction Finance Corporation claim, as proposed, would violate the priorities recognized by the approved plan and would, of course, as the stockholders desire, prevent the consummation of the plan.

In this connection we call attention to the position taken by the same interests as late as October 13, 1941, in the District Court, in opposition to a petition by certain creditor banks, whose claims are fully secured, to authorize certain payments to them *pursuant to the plan.* Although

the payments then proposed were small in relation to the indebtedness to the Reconstruction Finance Corporation, the stockholders opposed the payment and in their answer alleged, as follows:

> "5. Further answering, Debtor states that the cash now in the hands of the Trustee should be kept intact, as upon the amount of such cash depends the workability of any plan of reorganization which might be put into effect, and the emergencies of national defense might require a sudden expenditure of funds not now anticipated, to meet the demands of which an adequate supply of cash should be maintained."

2. The earnings of the property in the period since the effective date of the plan confirm the action of the Commission in excluding the stock interests from participation in the reorganized company. Those earnings do not permit a full return on the new preferred and common stocks which are taken by senior creditors on the basis of $100.00 per share.

The Balance Sheet, as of October 31, 1942 (Stockholders' Brief, Appendix A, Sheet 2) with its catalogue of investments in physical property furnishes no criterion of the fairness of the Commission's plan.[1]

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[1] Reference may be made to two items in the note appended to the balance sheet entitled: "The following payments for redemption of debt and interest have been made since June 28, 1935." Under the caption "Redemption of debt"—"Period June 28, 1935 to October 31, 1942" we find this item:

"Equipment Trust Certificates $20,425,000."

A fact not disclosed by the statement is that in the same period the Trustee of the property found it necessary to issue new equipment trust certificates in the amount of $21,535,000 with a resulting *increase* in outstanding certificates of more than a million dollars.

Under the caption "Payment of Interest—Period June 28, 1935 to October 31, 1942" this item appears:

"Bonds $13,685,345.65."

As we have pointed out elsewhere herein the accruals of *unpaid* interest to December 31, 1942 in spite of such payments, amount to $102,617,600.

We submit that the final test of any contention that the recent earnings of the estate show value in the old stock is to see what return those earnings produce for the senior creditors on the securities which they receive under the plan.

The two principal liens on the property are the General Mortgage on the lines east of the Missouri River under which bonds are outstanding in the principal amount of $132,019,000, and the First and Refunding Mortgage, first lien on the lines west of the Missouri River under which bonds are outstanding in the principal amount of $47,822,000. On January 1, 1939, the effective date of the plan, the claim per $1,000 General Mortgage 5% bond, amounted to $1,183, and the claim per $1,000 First and Refunding 5% bond, to $1,179.[1] On the opposite page a statement prepared at our request by the Trustee's Comptroller shows the classes and amounts of new securities allotted under the plan in compensation for these respective claims and sets out the maximum amount distributable to those securities in each of the four years (1942 estimated) since the effective date of the plan. For the purpose of this tabulation it has been assumed that the entire income technically available for distribution to the preferred and common stocks, is actually paid on these stocks, although in practice, of course, such a complete distribution would be unlikely. On this basis, the tabulation shows that on the securities allotted to the General Mortgage bondholder per $1,183 of claim, he would receive an average annual return for the four-year period of 2.986%. The First and Refunding bondholder would receive, per $1,179 of claim, an average annual return for the four-year period of 2.46%.[1]

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[1] The total claim on General Mortgage and First and Refunding bonds varies slightly in accordance with the interest rates which the different classes of those bonds bear.

EARNINGS AVAILABLE AND RATE OF RETURN ON C. & N. W. GENERAL MORTGAGE 5% BONDS, BASED ON NEW SECURITIES ALLOTTED IN I. C. C. REORGANIZATION PLAN, YEARS 1939 TO 1942, INCL. (1942 ESTIMATED).(1)

Earnings A

		1939		1940	
C. & N. W. General Mortgage 5% Bond		Rate		Rate	
Par value	$1000				
Amount of claim 12/31/38	1183				
New securities allotted in I. C. C. Reorganization Plan:					
1st & Gen. Mtge. Bonds	208	3¼	$6.76	4¾	$ 9.88
Income bonds	485	—	—	2.72	13.19
Preferred stock	447	—	—	—	—
Common stock	43	—	—	—	—
Total			$6.76		$23.07
Rate on return:					
On par value			0.676%		2.307%
On amount of claim			0.571%		1.950%
C. & N. W. 1st & Refunding Mortgage 5% Bond					
Par value	$1000				
Amount of claim 12/31/38	1179				
New securities allotted in I. C. C. Reorganization Plan:					
1st & Gen. Mtge. bonds	154	3¼	$5.01	4¾	$ 7.31
Income bonds	233	—	—	2.72	6.34
Preferred stock	307	—	—	—	—
Common stock	485	—	—	—	—
Total			$5.01		$13.65
Rate of return:					
On par value			0.501%		1.365%
On amount of claim			0.425%		1.157%

Accounting Department.

December 22, 1942.

(1) This statement was prepared and is certified as correct by the Trustee's C
ame Appendix we direct attention also to another statement prepared by the C
ixed charges under I. C. C. Reorganization Plan. Years 1939, 1940, 1941 and

tAL MORTGAGE 5% BONDS AND FIRST & REFUND-
D BY I. C. C. REORGANIZATION PLAN, FOR THE

vailable for New Securities

1941 Rate	1941	1942 (Estimated) Rate	1942 (Estimated)	Total Four Years	Average Per Year
4	$ 8.32	4	$ 8.32	$ 33.28	$ 8.32
4½	21.83	4½	21.83	56.85	14.21
4.47	19.98	6.36	28.43	48.41	12.10
—	—	6.36	2.73	2.73	.69
	$50.13		$61.31	$141.27	$ 35.32
	5.013%		6.131%		3.532%
	4.238%		5.183%		2.986%
4	$ 6.16	4	$ 6.16	$ 24.64	$ 6.16
4½	10.48	4½	10.48	27.30	6.83
4.47	13.72	6.36	19.53	33.25	8.31
—	—	6.36	30.85	30.85	7.71
	$30.36		$67.02	$116.04	$ 29.01
	3.036%		6.702%		2.901%
	2.575%		5.684%		2.460%

'omptroller. See Appendix B, this brief. As a part of the
'omptroller entitled "Disposition of income available for
1942 estimated."

It will be noted that under the allocation studies on which the distribution of securities provided by the plan was based, the General Mortgage bondholders received for each $1,000 bond, $447 of preferred stock and $43.00 of common stock—both taken at $100 per share. The First and Refunding bondholders received $307 of preferred stock and $485 of common stock. Four years have elapsed since the effective date of the plan. In 1939 the road did not earn the interest on the new income bonds. The increase in railroad traffic due to war conditions began early in 1940[1], but in that year interest was earned on the income bonds at the rate of only 2.72% and nothing was earned on the new stocks. It was not until 1941, the third of these four years, that there were any earnings on the new preferred stock and nothing was available for the new common stock until this year, the fourth, when the war effort produced an unprecedented volume of traffic. The earnings available for the new preferred and common stocks, in 1942 were at the rate of $6.36 per share,[2] and as stated it would be

[1] War was declared to exist between Great Britain, Germany, France and Poland on September 3, 1939, and a limited national emergency was proclaimed by the President of the United States on September 8, 1939. The Office for Emergency Management was established by the administrative order of the President on May 25, 1940. The Office of Production Management was created by executive order of the President on January 9, 1941, and the Lend-Lease Aid Act was approved March 11, 1941.

[2] The "earnings available for new securities" shown in this tabulation for the preferred stock and common stock are on the basis of the federal income taxes accrued by the Trustee on the books of the company. In computing the taxes thus accrued the amount of interest deducted from income was that accruing on the fixed and contingent interest bearing securities to be issued under the plan and not the larger amount of interest which is still actually accruing on the old securities. The actual tax liability of the property for the period since the effective date of the plan has not been determined. It will be contended, and we believe soundly, that until the actual consummation of the plan, the debtor should have the benefit of the interest actually accruing under the old capital structure, but however that question may be determined, the amount of the income tax accrued on the books by the Trustee in Bankruptcy and reflected in the Comptroller's tabulation will be the amount payable by the reorganized company after the consummation of the plan on the same level of income, assuming, of course, no change is made in the tax rates.

necessary that every penny of this amount be actually distributed to bring the average annual return of the senior creditors,—the General Mortgage bondholders and the First and Refunding mortgage bondholders for the four-year period, up to 2.986% and 2.46%.

In contrast to the contention that present conditions indicate value in the old preferred and common stocks we direct attention to the values which the public has placed upon the *new* stocks, as reflected in the current market transactions in those securities on a "when issued" basis, as reported by "The Commercial and Financial Chronicle." On December 18, 1942, the quotations were as follows:

Preferred stock $24.00 per share.
Common stock $5.25 per share.

3. The approved plan is based on the true, long term earning capacity of the road as shown by the comprehensive studies described below.

The Commission recognized that its duty under the statute was to formulate a plan which would serve as a basis for the financial structure of the reorganized company for the indefinite future. It would have been most improper for the Commission to have attempted to base its plan for this property on the results of an abnormal period, since the income in past years has fluctuated from a high of some thirty million dollars down to slightly more than a million dollars. The Commission made no such attempt. Instead it based its plan on the most reliable and informative data available as to the road's normal expectancy of income. The chief traffic, operating and accounting officials in the employ of the Trustee in Bankruptcy, who had long occupied similar positions with the debtor before bankruptcy, assisted by a large staff, labored for many

months in making the necessary investigations. (R. 2094, 2204, 2237.) Their searching studies as to what might reasonably be expected in the normal future year covered the volume of production and movement of each class of traffic, the total freight tonnage, the average haul, the applicable ton-mile rate, and the total income from freight and all other sources and the expenses of operation.[1] (R. 3512-7.)

Each of these subjects required the assembling and consideration of a mass of statistical and historical data. A thorough examination was made of the volume, consist and trend of traffic handled by the debtor during the preceding twelve years, together with the earnings derived therefrom. In the development of this data, studies were made also of traffic handled by the debtor's principal railroad competitors, and the relation of the debtor's traffic to the entire volume in the territory. (R. 2122-2124.) A survey was made of the past and prospective movement of agricultural traffic by competing agencies of transportation, such as trucks and waterways, and consideration was given to the long range effect of such movement upon the volume to be handled and the rates which could be maintained thereon. (R. 2104-2109; Com. Exs. 359, 368.) The trends in general population and farm population and of farm income in the states served by the debtor were studied and compared with those for the country as a whole. (R. 2112-2113; Com. Exs. 369, 370.) Field studies were carried on throughout the entire territory served by the railroad to

[1] While earning power in the prospective normal year was used as the primary determinant of value, the Commission gave weight to all other relevant elements. In order to permit the fullest possible participation in the reorganized company, the Commission substantially increased the new capitalization beyond that "supported by the earnings of the normal year reasonably to be expected," as shown by these studies, by taking "into account the reproduction value of the property and the favorable past earnings, as well as the unfavorable recent and prospective earnings." (R. 3658, 3579.)

obtain the opinions of county agents, state agricultural officers, rural traffic officers and station agents of the debtor and other railroads. Extensive use was made of the facilities of every agricultural college in the territory served. A detailed questionnaire was submitted to the agricultural agent in each county through which the debtor operates and the returns collated and analyzed. (R. 2124-2134.) An extensive survey was made of the rate level and the trend of rates over a long period of years, as a basis for assumptions as to the rate level reasonably to be anticipated in the future. (Com. Ex. 380, sheet E.) All available technical information and advice was collected to determine the normal precipitation in the territory served, and the production to be anticipated under conditions of normal rainfall. (R. 2100-2101; Com. Exs. 355-356.) Normal agricultural policies were studied as to their probable bearing upon the production and export of agricultural commodities. (R. 2095-2096.) Similar painstaking investigations were made of all of the principal commodities transported. Detailed consideration was given to the all important factor of competition with trucks and other forms of transportation with respect to each principal commodity transported. (Com. Exs. 380, 382, 384, 385 and 391.)

Based upon this intensive survey of traffic trends and prospects, three detailed estimates of earning power in the normal future year were presented,—one by the department heads of the carrier, one by the Mutual Savings Bank Group and one by the Life Insurance Group. These three estimates differed to some extent but were within a reasonably close range. The Commission weighed all of the evidence and then reached its own conclusions as to the carrier's normal expectancy of income. These it embodied in the approved plan.

Certainly no greater disservice could have been done this property and all who have a real interest in it than for

the Commission to have based its plan on abnormal conditions. Reliance upon war boom earnings would ignore the lessons "from past experience that the upswing in business which war brings is temporary and likely to be followed by an aftermath in which conditions are worse than before."[1] "The principles of sound financing and the public interest" prevent the Commission from so ignoring the lessons of history in approving capitalizations for reorganization railroads.[2]

On August 10, 1942, in its report in the *Florida East Coast* reorganization the Commission stated:

> "Under present conditions, the fact that the year 1942 gives promise of producing even larger earnings than 1941 affords too uncertain and precarious a basis to justify the increases [in capitalization] sought."[3]

We submit that the Commission correctly formulated its plan of reorganization for this property on a long-term basis so that the plan may meet the needs of the carrier, its security holders, and the public, during the years, both good and bad, which lie ahead.

4. The efforts of debtors to put off the day of reckoning are unending and to reopen this record under the circumstances here would be contrary to the intent and purpose of Section 77.[4]

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[1] Fifty-third Annual Report of the Interstate Commerce Commission to Congress, p. 5.

[2] *New York, New Haven & Hartford Railroad Company Reorganization* (Finance Docket No. 10992) ..... I. C. C. .....

[3] *Florida East Coast Ry.* (Finance Docket No. 13170) .... I. C. C. .....

[4] In *Continental Bank* v. *Rock Island R. Co.*, 294 U. S. 648, the Court said:

> "The delay and expense incident to railroad receiverships and foreclosure sales constituted, probably, the chief reasons which induced the passage of § 77; and to permit the perpetuation of either of these evils under this new legislation would be subversive of the spirit in which it was conceived and adopted." (p. 685)

Speaking of the effect of war conditions upon the railroad enterprise Mr. Eastman has said:

> "Let me suggest, however, that those who regard these present earnings as evidence of the unsoundness of our reorganization plans may well give heed to the source from which these earnings spring and to the future conditions which are likely to flow from this same source. * * * All this in the end means burden and sacrifice for all concerned. * * *"(1)

The same conditions which have imposed a staggering burden of war traffic upon the railroads have also made necessary large capital expenditures to meet a condition which is obviously temporary. The general rise in prices has not only increased the cost of materials and supplies but brought an early demand by railroad labor for increased wages. The settlement of that demand late in 1941, following a recommendation by the President's Emergency Board, increased the expenses of the railroad as a whole by approximately $311,711,000. Of necessity, higher income taxes have been imposed but no showing in respect to these charges against income is made in the evidence tendered by the motion under discussion.

To offset partially the increased cost of railroad operation the Interstate Commerce Commission authorized increases in passenger and freight rates which became effective early in 1942. The Price Administrator on his own behalf and on behalf of James F. Byrnes, Director of Economic Stabilization, the Secretary of Agriculture and other governmental agencies have now petitioned the Commission to remove these increases. In the face of that threat to their revenues railroad labor is now demanding a second increase in wages. The total demand of all crafts is estimated to be in excess of $650,000,000. The experience of the railroads over the years shows that their revenues and expenses are

(1) Published Address of Commissioner Eastman before the National Association of Mutual Savings Banks at Philadelphia on May 7, 1941.

so constantly subject to forces of this character that their earning position is not stable for any extended period. It has already been demonstrated that the reorganization of a large railroad under Section 77 cannot be consummated in a short period over the opposition of the stock interests. The earning data for this estate continued to be incorporated in the record long after the proceeding was docketed in the Court of Appeals and almost to the date of its decision. It is submitted that if the purpose of the statute is to be accomplished there must come a time when the record is finally closed. The excluded stock interests should not be permitted to secure a reopening of the record to tender proof of the new factors affecting income which are constantly arising.

We respectfully ask that the motion be denied and that the petitions for certiorari likewise be denied. We particularly ask that if certiorari be denied this Court neither expressly nor impliedly, as requested by the stock interests, authorize the District Court to entertain a motion that it nullify and make impossible the consummation of the approved plan by directing payment of the large indebtedness to the Reconstruction Finance Corporation.

Respectfully submitted,

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Of Counsel.

EARNINGS AVAILABLE AND RATE OF RETURN ON C. & N. W. GENERAL MORTGAGE 5% BONDS AND FIRST & REFUNDING MORTGAGE 5% BONDS, BASED ON NEW SECURITIES ALLOTTED BY I. C. C. REORGANIZATION PLAN, FOR THE YEARS 1939 TO 1942, INCL. (1942 ESTIMATED).

		Earnings Available for New Securities									
		1939		1940		1941		1942 (Estimated)		Total Four Years	Average Per Year
C. & N. W. General Mortgage 5% Bond		Rate		Rate		Rate		Rate			
Par value	$1000										
Amount of claim 12/31/38	1183										
New securities allotted in I. C. C. Reorganization Plan:											
1st & Gen. Mtge. Bonds	208	3¼	$6.76	4¾	$ 9.88	4	$ 8.32	4	$ 8.32	$ 33.28	$ 8.32
Income bonds	485	—	—	2.72	13.19	4½	21.83	4½	21.83	56.85	14.21
Preferred stock	447	—	—	—	—	4.47	19.98	6.36	28.43	48.41	12.10
Common stock	43	—	—	—	—	—	—	6.36	2.73	2.73	.69
Total			$6.76		$23.07		$50.13		$61.31	$141.27	$ 35.32
Rate on return:											
On par value			0.676%		2.307%		5.013%		6.131%		3.532%
On amount of claim			0.571%		1.950%		4.238%		5.183%		2.986%
C. & N. W. 1st & Refunding Mortgage 5% Bond											
Par value	$1000										
Amount of claim 12/31/38	1179										
New securities allotted in I. C. C. Reorganization Plan:											
1st & Gen. Mtge. bonds	154	3¼	$5.01	4¾	$ 7.31	4	$ 6.16	4	$ 6.16	$ 24.64	$ 6.16
Income bonds	233	—	—	2.72	6.34	4½	10.48	4½	10.48	27.30	6.83
Preferred stock	307	—	—	—	—	4.47	13.72	6.36	19.53	33.25	8.31
Common stock	485	—	—	—	—	—	—	6.36	30.85	30.85	7.71
Total			$5.01		$13.65		$30.36		$67.02	$116.04	$ 29.01
Rate of return:											
On par value			0.501%		1.365%		3.036%		6.702%		2.901%
On amount of claim			0.425%		1.157%		2.575%		5.684%		2.460%

Accounting Department. December 22, 1942.

I, Charles H. Westbrook, Comptroller of Chicago and North Western Railway Company, do hereby certify that except for the parts of the foregoing statement marked "Estimated" the figures contained therein are true and correct as shown by the books and records of said trust estate; that the parts marked "Estimated" reflect my own judgment of the estimated results for the period indicated, actual figures for a portion of said period not being presently available, and the tabulations involving an application of the approved plan of reorganization reflect my own interpretation thereof.

Dated at Chicago, Illinois, this 29th day of December, 1942.

CHARLES H. WESTBROOK.

DISPOSITION OF INCOME AVAILABLE FOR FIXED CHARGES UNDER THE I. C. C. REORGANIZATION PLAN
Years 1939, 1940 and 1941, and 1942 Estimated

	1939	1940	1941	1942 (Estimated)	Total 1939-1942
ome available for fixed charges.	$ 7,345,481	$11,224,665	$17,793,040	$23,700,000	$60,063,186
Less interest and dividends from U. P. Stock and N. Y. C. Bonds	173,860	173,860	173,860	174,000	695,580
	$ 7,171,621	$11,050,805	$17,619,180	$23,526,000	$59,367,606
ed Charges:					
Rent for leased roads and equipment	$ 4,967	$ 5,427	$ 5,576	$ —	$ 15,970
Interest on equipment trust certificates	404,983	351,740	311,187	525,000	1,592,910
Fixed interest on new securities.	2,402,842	2,379,882	2,361,464	2,351,500	9,495,688
Interest on unfunded debt	69,432	146,240	95,785	56,000	367,457
Total fixed charges	$ 2,882,224	$ 2,883,289	$ 2,774,012	$ 2,932,500	$11,472,025
Available net income	$ 4,289,397	$ 8,167,516	$14,845,168	$20,593,500	$47,895,581
plication of available net income:					
Annual maturities of notes	$ 456,033	$ 456,033	$ 456,033	$ 456,000	$ 1,824,099
Sinking fund on divisional bonds	32,500	32,500	32,500	32,500	130,000
Accrual of additions and betterments fund	3,000,000	3,000,000	3,000,000	(a)	9,000,000
Sioux City Bridge Co. dividend applied in reduction of R.F.C. principal	50,000	50,000	50,000	50,000	200,000
	$ 3,538,533	$ 3,538,533	$ 3,538,533	$ 538,500	$11,154,099
come available for contingent interest	$ 750,864	$ 4,628,983	$11,306,635	$20,055,000	$36,741,482
cess income assignable to commutable interest from 1939	—	120,425	—	—	—
mmutable interest earned and payable (c)	630,439	1,891,317 (b)	1,260,878	1,255,000	5,037,634
come available for interest on income bonds	—	$ 2,858,091	$10,045,757	$18,800,000	$31,703,848
terest on income bonds, earned and payable	—	2,626,473 2½%	4,727,651 4½%	4,727,500 4½%	12,081,624
come reserved for income bond interest	—	231,618 .22%	—	—	231,618
t income after providing for interest on income bonds	—	—	$ 5,318,106	$14,072,500	$19,390,606
nking fund for income bonds	—	—	525,295	525,500	1,050,795
Balance for stock			$ 4,792,811	$13,547,000	$18,339,811
Preferred Stock	—	—	$ 4,792,811 4.47%	$ 6,686,000 6.36%	$11,478,811
Common Stock	—	—	—	6,861,000 6.36%	6,861,000

) Depreciation on roadway property substituted for A. & B. fund contribution from income in 1942, included as an operating expense charge in arriving at "Income available for fixed charges."

) Includes $630,439 (¾%) not earned in 1939.

) Commutable contingent interest, having been earned for three successive years, becomes fixed as of January 1, 1943.

I, Charles H. Westbrook, Comptroller of Chicago and North Western Railway Company, hereby certify that except for the parts of the foregoing statement marked "Estimated" the ures contained therein are true and correct as shown by the books and records of said trust es that the parts marked "Estimated" reflect my own judgment of the estimated results for period indicated, actual figures for a portion of said period not being presently available, and tabulations involving an application of the approved plan of reorganization reflect my own in pretation thereof.

Dated at Chicago, Illinois, this 29th day of December, 1942.

CHARLES H. WESTBROOK

JAN 2 1943
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

Nos. 34-35-36.

IN THE MATTER OF

CHICAGO AND NORTH WESTERN RAILWAY COMPANY,

Debtor.

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, DEBTOR,

Petitioner,

vs.

MUTUAL SAVINGS BANK GROUP COMMITTEE, *et al.,*

Respondents.

ANSWER TO MOTION OF DEBTOR TO SUPPLEMENT RECORD

LEONARD D. ADKINS,
Attorney for Respondents
George W. Bovenizer, et al.,
15 Broad Street,
New York, N. Y.

December 31, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

IN THE MATTER OF CHICAGO AND NORTH WESTERN RAILWAY COMPANY, *Debtor.* CHICAGO AND NORTH WESTERN RAILWAY COMPANY, DEBTOR, *Petitioner,* VS. MUTUAL SAVINGS BANK GROUP COMMITTEE, *et al.*, *Respondents.*	Nos. 34-35-36.

ANSWER TO MOTION OF DEBTOR

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The undersigned counsel for George W. Bovenizer, *et al.*, as a Committee for Holders of Collateral Notes of the Debtor, Chicago and North Western Railway Company, one of the Respondents in the above-entitled cases, answering the "Motion to Supplement Record" dated December 17, 1942, filed by counsel for the Debtor herein, respectfully states as follows:

1. The petitions for certiorari pending in this Court in the above and companion Dockets relate to certain orders or decrees of the United States Circuit Court of Appeals for the Seventh Circuit affirming certain orders of the District Court of the United States for the Northern District of Illinois, Eastern Division, including an order, entered June 27, 1941, confirming the Plan of Reorganization of the Debtor, Chicago and North Western Railway Company.

2. In passing on said petitions for certiorari, this Court is concerned only with the question whether said decrees or orders of the Circuit Court of Appeals affirming said orders of the District Court involved questions of public or general interest or questions in respect of which conflict existed as among the several Circuit Courts. It is entirely obvious that the material which counsel for the Debtor seeks to add to the record can have no bearing on this Court's determination of that question.

3. Even if this Court should decide to grant one or more of the pending petitions for certiorari, the only question to be considered by this Court would be the correctness of the action taken by the Circuit Court of Appeals on February 9, 1942 in affirming said orders of the District Court entered on June 27, 1941. It is equally obvious that the material which counsel for the Debtor seeks to add to the record can have no bearing on that determination, since all such material relates to events subsequent to June 27, 1941. The correctness of the action taken by the District Court on June 27, 1941 cannot be determined by subsequent events.

4. The rights of the parties in respect of the reorganization of the Debtor became finally fixed, under the provisions of Section 77 of the Bankruptcy Act, when the District Court confirmed the Plan, subject only to reversal, on appeal, of the order confirming the Plan. If this Court should refuse to grant certiorari or should grant certiorari and thereafter affirm the decision of the Circuit Court of Appeals, the District Court would have no power to entertain the proposed petition (referred to in the Motion to Supplement Record) to pay off the debt to Reconstruction Finance Corporation, if such payment would change the rights of the parties under the Plan. It would, therefore, be obviously improper for this Court, if it should refuse to grant certiorari, to state, as requested by counsel for the Debtor, that such refusal was without prejudice to the Debtor's right to file such a petition in the District Court.

5. Wherefore, respondents George W. Bovenizer, *et al.*, respectfully urge that the Debtor's Motion to Supplement Record be denied in its entirety.

LEONARD D. ADKINS,
Attorney for Respondents
George W. Bovenizer, et al.,
15 Broad Street,
New York, N. Y.

Dated at New York, N. Y.,
December 31, 1942.

BRIEF IN SUPPORT OF ANSWER

The Motion to Supplement Record is in form simply a request to have included in the Record certain information in regard to the current earnings and current cash position of the Debtor's estate. We have no objection to having this Court take judicial notice of the fact that the Debtor, in common with all other railroads, is at the present time enjoying large earnings as a result of war conditions and by reason of such earnings has accumulated substantial amounts of cash, so long as it also takes judicial notice of the obviously temporary nature of such earnings.

The real purpose of the Motion, however, is to persuade this Court to take the position that this Plan of Reorganization should be scrapped, not because of any error in the decisions which this Court has been asked to review, but because of the present prosperity of the Debtor and other railroads due to war conditions.

The petitions for certiorari were filed to ask this Court to review the correctness of the Circuit Court's decrees entered February 9, 1942 (Tr. 5816 ff.) affirming the action taken by the District Court in approving and confirming the Plan. The Motion to Supplement Record suggests the novel principle of law that the correctness of those decrees of the Circuit Court should be determined, not on the basis of the record before that Court and the facts as they existed at the date of those decrees, but on the basis of events subsequent to the date of entry of those decrees.

The Circuit Court of Appeals was well aware of the current war prosperity of the Debtor at the time of the entry of its decrees. In its opinion the Court said (Tr. 5804):

> "This radical change (for the better) in the past year can not and should not be ignored. * * * It is something we can, and should, and do, take judicial notice of. It is, we believe, temporary, and like a crop failure year, in the Northwest—which this Debtor serves—not to be taken too seriously when viewing the long future of this railroad. In making this statement we are aided by the experiences of railroads during and after the last war."

Counsel for the Debtor rely primarily on this Court's decision in *Atchison, T. & S. F. R. Co.* v. *United States,* 284 U. S. 248 (1932), and other cases in which this Court considered the effect of economic changes on the reasonableness of rates fixed without regard to such changes. There is no analogy between those cases and the present case. In the *Atchison* case the Interstate Commerce Commission, in a proceeding to lower rates on grain and other farm products, had refused to permit a rehearing for the introduction of evidence of a drastic nationwide decline in railroad earnings which had occurred after the close of the hearings before the Commission. This Court held that the Commission had acted improperly in refusing to receive the additional evidence tendered.

There are two basic distinctions between the situation in the present case and that presented to this Court in the *Atchison* case. In the *Atchison* case this Court's problem was whether rates fixed on the basis of relatively high railroad earnings could be permitted to stand when there had been a complete change in the level of earnings. Since rates must be fixed so as to yield reasonable compensation, they are necessarily subject to change from time to time as a result of shifting economic conditions. They are not fixed